

ORANGE COUNTY CHAPTER

A&D FORUM

PRIVATE EQUITY STRATEGY FOR NAVIGATING THE A&D MARKET IN 2021

PANEL RECAP



BOB SEARCH
EST. 1979

THE AEROSPACE AND DEFENSE EXECUTIVE SEARCH FIRM



PANELISTS

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FORUM HIGHLIGHTS



SUMMARY:

The discussion covered several categories, including defense, space, and commercial from the standpoint of privately held middle market companies in the A&D supply chain.

The panel was comprised of CEO's of private equity-owned aerospace manufacturing companies, along with the buyers and sellers of such companies.

DEFENSE INDUSTRY

As the commercial aerospace, tourism and hospitality industries struggle during an enormous downturn, defense portfolios are sustaining many businesses.

- The current cycle is an important reminder why platforms and market diversity are a cornerstone of A&D investments. Given the current environment, investors are seeking resiliency in their A&D investments.
- The outcome of the election should not be a deterrent to defense for at least the next 2 years, especially on programs that are well underway.
- You must dissect the defense budget into its key categories: Capital Spend, R&D, and Operations and Maintenance. Over the next 5-7 years, key programs and drivers include:
 - Capital Spend: F-35, Columbia Class Submarine, and Minuteman Missile.
 - R&D: mandates around unmanned and autonomous unmanned vehicles, hypersonic missiles, and launch vehicles.
 - Operations and Maintenance: reconfiguration or life extension of legacy platforms such as re-winged of the F-15 and F-18, communications (enabling legacy platforms to communicate with new platforms) and munition programs.
- Foreign military sales have grown tremendously to \$83.5B in 2020, a 50%+ increase over 2019.
- These include F-16's and other platforms, being sold to countries outside the middle east. There is a corresponding aftermarket and sustainment element associated with these sales.
- For engine component manufacturers, the pivot is similar: F-135, F404 (TX Trainer), and other defense related engines programs.
- Keep an eye on privatization of military assets, which could open up new customer channels and consumption habits.
- Take note of cybersecurity requirements, which must be flowed to the lowest levels of your organization. Threats can appear relatively innocuous and training is required at every level of the organization to counter and prevent potential attacks.
- As things become smarter and increase in computing power, the power requirements go up and heat dissipation becomes increasingly important - this could lead to a market opportunity.

COMMERICAL AEROSPACE

During the discussion of the commercial aerospace market, the panel's overall expectations on recovery was conservative, with an agreement that the bottom of the market has not been hit, and likely won't until Q1 2021. The panel does not expect passenger travel volumes to return until 2023 or 2024.

- The airline customer is severely distressed, with daily cash burn of \$35M - \$50M across the major U.S. carriers.
- Fleet composition has changed significantly. This reconfiguration is having a dramatic affect on the aftermarket, and what were previously thought as the winners and losers has shifted significantly.
- Long term, narrow body / single aisle will comprise the majority of the fleet due to the economics. This includes international travel.
- Airbus looks to be the winner for the foreseeable future as Boeing has no answer for the A321XLR. Pivoting to Airbus will be challenging for North American suppliers, as their supply chain is very European-centric.
- The panel was asked whether they foresee single aisle build rates between Boeing and Airbus combined dropping below 30 per month in the future. The consensus was there is a 50% chance of that happening, and the only reason it's not higher than 50% is because Airbus's unions may not allow them to reduce production further.
- There is a lot of inventory in the supply chain, and companies further up in the supply chain are de-stocking. However, there is not good inventory visibility throughout the supply chain. Keep an eye on expedite orders as a leading indicator for when the market is in recovery.
- On the M&A side, you have to wait to see what orders are going to be cancelled, what capacity is going to be, what build rates are going to be, and allow the bankruptcies to occur before you can deploy capital and invest in commercial businesses.
- It is important to remember we just ended a 10-year up-cycle in commercial aerospace.
- While air travel has dropped, it will return – **People will still fly.**

SPACE

The other natural pivot for companies impacted by the commercial downturn is space, which is bifurcated like aviation between commercial and defense.

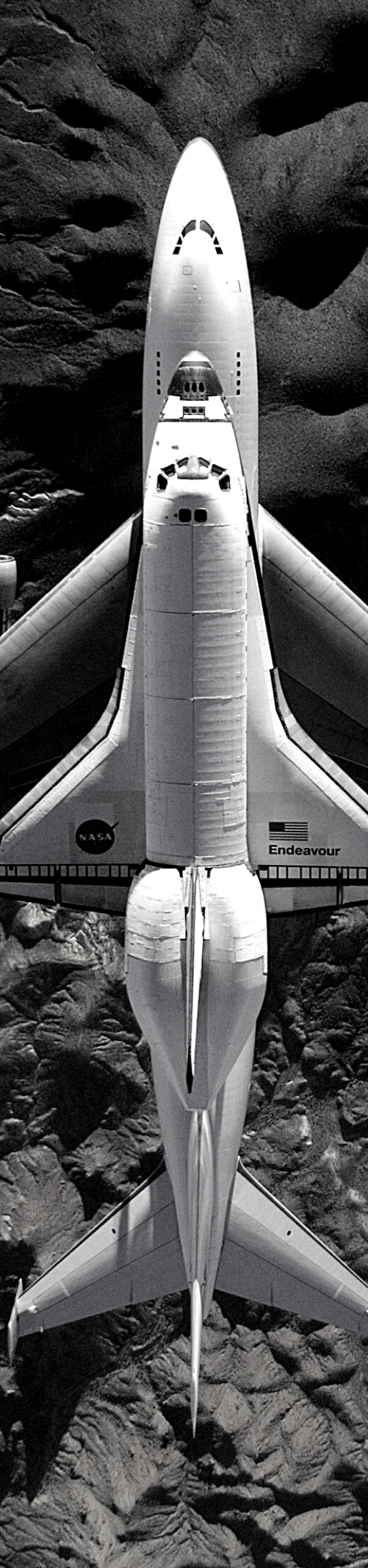
- While commercial space grabs the headlines, the defense side appears the more sustainable and promising.
- Hypersonics, top secret programs, defending space-based assets, and the new Space Force are all drivers for government led spending in space.

OTHER MARKETS

The panel cautioned against a significant expansion to non-core markets.

- In the short term, your business will be relieved, but branching out and overdiversification will dilute the value of your business long term.

"There's no easy button in our current market. Sustaining long term is staying true to the core of your business."



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